



Local Government Pension Scheme - Exit Payment Reform

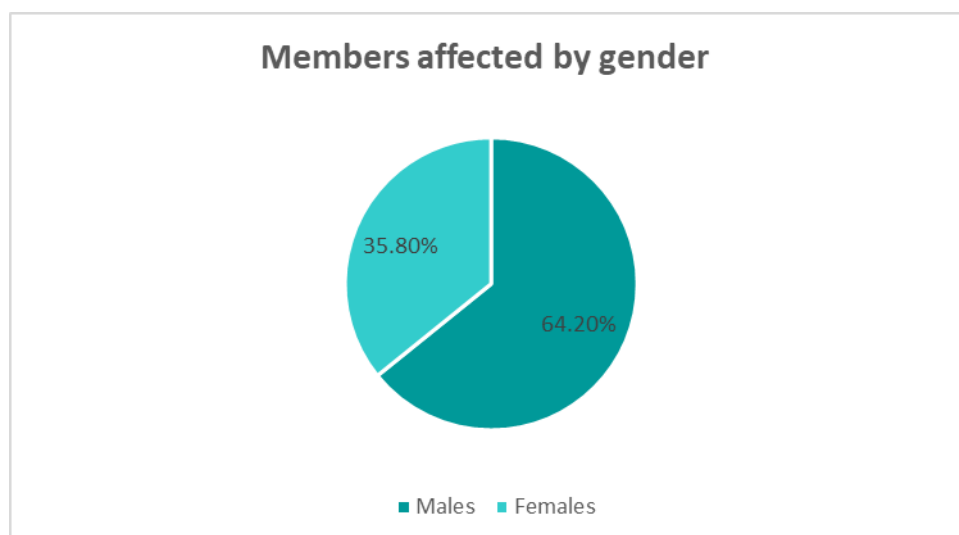
This note has been prepared by GAD at the request of MHCLG to support their forthcoming consultation on exit payment reform in the Local Government Pension Scheme (LGPS). The purpose of this note is to provide analysis of the impact of the proposed reforms to exit payments on members.

Executive Summary

- The majority of members (86%) ceasing employment on grounds of redundancy are affected by the proposed reforms to exits payments. That is, based on data of those members made redundant during 2013-2016, 86% received higher benefits than they would be entitled to under the proposed reform.
- This is largely driven by the change to benefits on redundancy given under the proposed reforms, members are not entitled to payment of statutory redundancy pay or discretionary severance pay in excess of the pension strain.
- More female members are affected by these proposed reforms. This is due to females making up a greater proportion of the overall membership, and all redundancies over 2013-2016 than males.
- The members affected by these proposed exit payment reforms have a broadly similar profile to the average profile of all members ceasing employment on grounds of redundancy over the period 2013-2016.
- The members most affected by the proposed reforms have a slightly higher salary than the average salary for all members ceasing employment on grounds of redundancy over the period 2013-2016.

The chart below illustrates the gender split of the members affected by the proposed exit payment reforms over the period 2013-2016.

Chart 1: Members affected by proposed reforms, by gender



1 Summary of approach

1. Members ceasing employment on grounds of redundancy have the right to a number of exit payments. Under the proposed reforms, these benefits are subject to an exit payment cap of £95,000.
2. Members over age 55 ceasing employment on grounds of redundancy have the right to an immediate pension, which is not reduced to reflect early payment. If the member elects to receive an immediate unreduced pension, the member is not entitled to additional redundancy cash payments. However, members may also be awarded a cash payment where the pension strain is less than statutory redundancy pay (SRP). Members are also entitled to a cash payment where the pension strain (less statutory redundancy pay) is less than the discretionary severance pay (DSP) members would have been entitled to.
3. In practice, members have a number of options for benefits on redundancy. This report assumes all members elect for payment of immediate unreduced benefits **only**. It is assumed that the member does not elect to have statutory redundancy pay as cash, in exchange for reduced immediate benefits. It's also assumed that where a breach of the £95,000 cap occurs, the member does not make any cash payments to offset all or part of the breach.

Current approach

4. The current approach assumes that members are entitled to payment of unreduced benefits in addition to statutory redundancy pay plus discretionary severance pay.
5. There is no overall cap on benefits.

Proposed reform

6. The proposed exit payment reform approach considered in this note assumes that all eligible members elect for immediate unreduced pension.
7. In the case where a member's pension strain is less than the SRP, a cash payment is awarded up to the SRP.
8. Further to this, in the case where the DSP is less than the strain (net of SRP), the member is awarded a cash payment to the value of the DSP.
9. All benefits are subject to £95,000 cap.

2 Impact of reform on members

- The following table shows the proportion of members that are affected by the proposed exit payment reforms. The table gives the magnitude of the average loss (relative to the current situation) that members who are affected by the changes are likely to experience as a result of the imposition of each measure.

Table 1: Average impact on members of proposed reforms

| Measure | Proportion of Members Affected | Average size of loss to member (£K) | Percent Male | Average Salary ¹ (£ pa) | Average Age ² (years) | Average Service ³ (years) |
|------------------|--------------------------------|-------------------------------------|--------------|------------------------------------|----------------------------------|--------------------------------------|
| All Redundancies | n/a | n/a | 37.6% | 28.8 | 59.5 | 18.9 |
| Proposed reforms | 86.0% | 13.2 | 35.8% | 28.7 | 59.0 | 17.9 |

1 Average FTE pay

2 Average age unweighted

3 Average service estimated based on date of joining and date of exit

- Out of the redundancies considered over the period 2013-2016, 86% of these members would be affected by the proposed exit payment reforms. The average loss to members would be around £13,000.
- This is largely driven by the proposed reforms where members are no longer entitled to statutory pension strain and discretionary severance pay in excess of pension strain, rather than the £95,000 cap on benefits. In light of this, the £95,000 cap on benefits has a relatively small impact on the proportion of members affected.
- The following table below shows the proportion of members that are most affected by the proposed exit payment reforms. The table gives the magnitude of the average loss (relative to the current situation) that members who are affected by the changes are likely to experience as a result of the imposition of each measure.

Table 2: Highly impacted members overall

| Measure | 90th percentile size of loss (£K/ %) | Percent Male | Average Salary ¹ (£ pa) | Average Age ² (years) | Average Service ³ (years) |
|--------------------------------------|--------------------------------------|--------------|------------------------------------|----------------------------------|--------------------------------------|
| All Redundancies | n/a | 37.6% | 28.8 | 59.5 | 18.9 |
| Proposed reforms – top 10% loss in £ | £27k | 55% | 53.5 | 56.8 | 27.1 |
| Proposed reforms – top 10% loss by % | 47.5% | 35.6% | 30.1 | 59.0 | 18.2 |

1 Average FTE pay

2 Average age unweighted

3 Average service estimated based on date of joining and date of exit

- Of the 10% of the members most affected in monetary terms by this stand to lose more than £27k from their existing redundancy package. The typical profile of such members is above average earners (53.5k) with above average service (27.1 years).
- Of the 10% of members most affected in % terms by the proposed reforms stand to lose more than 47.5% of their current redundancy package. The typical profile of such members is slightly above average earners (£30.1k) with slightly below average service (18.2 years).

7. The table below sets out the sets out the active membership summary as at 31 March 2016 and is provided for illustration only. This table is replicated from the LGPS valuation data report dated 8 July 2020.

Table 3: Active data as at 31 March 2016

| | Number of records (000's) | Actual pensionable salary £m | FTE pensionable salary £m | Average Actual salary £ | Average age weighted by Actual Pensionable Salary | Average Reckonable service¹ | CARE pension £m |
|--------------|----------------------------------|-------------------------------------|----------------------------------|--------------------------------|--|---|------------------------|
| Total | 1,967 | 33,088 | 43,083 | 16,818 | 45.9 | 5.5 | 1,146 |

¹ Includes only pre-2014 service in the earlier final salary schemes

3 Worked examples

1. The following examples demonstrate the impact of the proposed reforms to exit payments on several hypothetical examples.
2. Under the reformed approach, members may also be awarded a cash payment where the pension strain is less than statutory redundancy pay. Members are also entitled to a cash payment where the pension strain (less statutory redundancy pay) is less than the discretionary severance pay members would have been entitled to. We've included any cash payments to member as "cash payment".

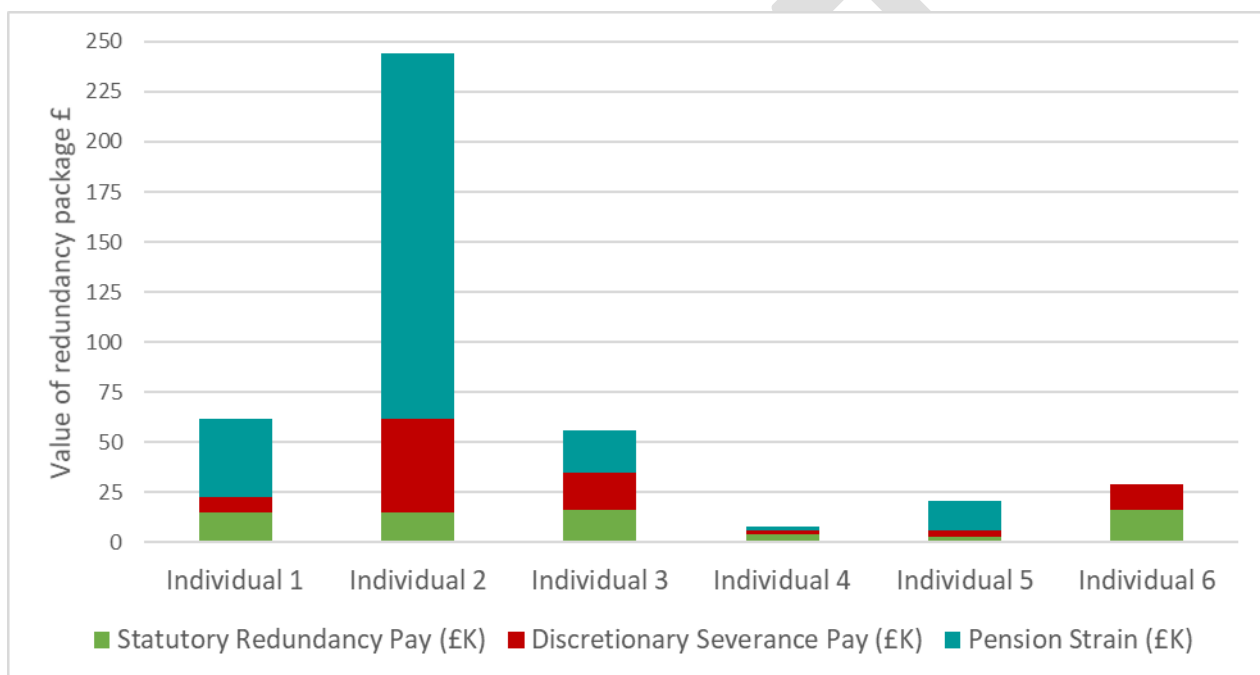
Hypothetical examples:

- **Individual 1:** is 59 years old. Member for 19 years and is currently paid a salary of £29,000 per annum. She broadly fits the profile of the average member. Her new redundancy package does not contain a cash payment on top, as her pension strain is larger than the combined SRP and DSP. Member benefits are not affected by the £95,000 cap but are reduced under proposed reforms as SRP and DSP are no longer paid in excess to pension strain. Under the proposed reforms, benefits on redundancy are reduced by around 37%.
 - **Individual 2:** is 55 years old and has been a member for 25 years. He is paid a salary of £80,000 per annum. His relatively young age means that he receives a high pension strain. Benefits are reduced under proposed reforms as SRP and DSP are no longer paid in excess to pension strain and pension strain is capped at £95,000. His new redundancy benefits are £95,000, as his pension strain is already over £95,000. Under the proposed reforms, benefits on redundancy are reduced by around 61%.
 - **Individual 3:** is 61 years old. He has been a member for 31 years and is currently paid a salary of £41,000 per annum. Member is entitled to a cash payment as the DSP the member would have been entitled to is higher than pension strain (net of SRP). Member benefits are not affected by the £95,000 cap but are reduced under proposed reforms as full SRP and DSP are no longer paid in excess to pension strain. His redundancy benefits are reduced by 38%.
 - **Individual 4:** is 65 years old. She has been a member 7 years and is currently paid a salary of £20,000 per annum. Member is entitled to a cash top up as pension strain is less than SRP, and DSP the member would have been entitled to is greater than strain (net of SRP). Member benefits are not affected by the £95,000 cap but are reduced under proposed reforms as full SRP and DSP are no longer paid in excess to pension strain. Under the proposed reforms, benefits on redundancy are reduced by around 25%.
 - **Individual 5:** is 60 years old. She has been a member for 4 years and is currently paid a salary of £35,000 per annum. Her new redundancy package does not contain a cash payment element as her pension strain is larger than the combined SRP and DSP. Member benefits are not affected by the £95,000 cap but are reduced under proposed reforms as full SRP and DSP are no longer paid in excess to pension strain. Under the proposed reforms, benefits on redundancy are reduced by around 29%.
 - **Individual 6:** is 67 years old and has been a member 23 years. She is currently paid a salary of £34,000 per annum. Her age and service history mean that there is no pension strain. The member is not affected by the £95,000 cap. Her redundancy package will be unchanged and will consist entirely of the cash payment which is equal to her original SRP plus DSP.
3. Table 3 and Chart 2 show the breakdown of the redundancy packages these hypothetical individuals would receive under the current approach. The total each member receives is the sum of statutory redundancy pay, discretionary severance pay and pension strain.

Table 3: Current approach

| Member | Statutory Redundancy Pay (£K) | Discretionary Severance Pay (£K) | Pension Strain (£K) | Member receives (£K): |
|--------------|-------------------------------|----------------------------------|---------------------|-----------------------|
| Individual 1 | 15 | 8 | 39 | 62 |
| Individual 2 | 15 | 47 | 182 | 244 |
| Individual 3 | 16 | 19 | 21 | 56 |
| Individual 4 | 4 | 2 | 2 | 8 |
| Individual 5 | 3 | 3 | 15 | 21 |
| Individual 6 | 16 | 13 | 0 | 29 |

Chart 2: The current situation



4. Table 4 and chart 3 show the benefits members will be entitled to following the proposed reform to exit payments.
5. The proposed exit payment reform approach considered in this note assumes that all eligible members elect for immediate unreduced pension.
6. In the case where a member's pension strain is less than the statutory redundancy payment, a cash payment is awarded up to the statutory redundancy payment. Also, in the case where the discretionary severance pay is more than the strain (net of SRP), the member is awarded a cash top up to the value of the discretionary severance payment. Any cash payment made to members is included under the cash payment. The total each member receives is the sum of the pension strain and cash payments.
7. All benefits are subject to £95,000 exit payment cap.

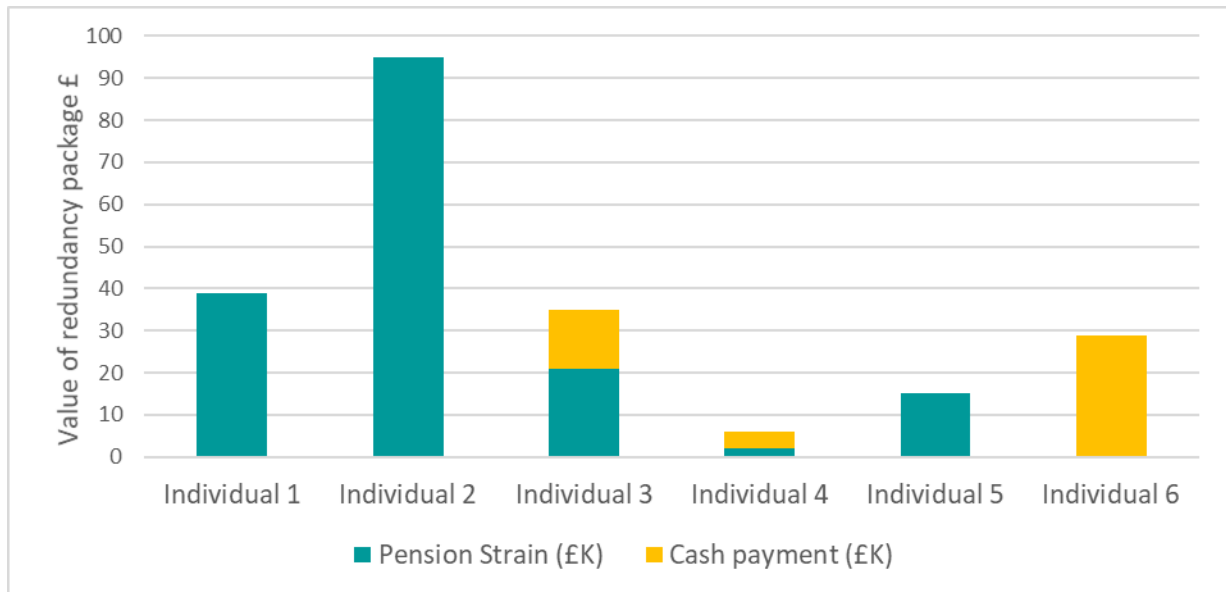
Table 4: Proposed reforms

| Member | Pension Strain (£K) | Cash payment (£K) | Member receives (£K): |
|---------------|----------------------------|--------------------------|------------------------------|
| Individual 1 | 39 | 0 | 39 |
| Individual 2 | 95 | 0 | 95 |
| Individual 3 | 21 | 14** | 36 |
| Individual 4 | 2 | 4** | 6 |
| Individual 5 | 15 | 0 | 15 |
| Individual 6 | 0 | 29 | 30 |

** For individual 3 a cash payment is due because the discretionary severance pay is more than the strain (net of SRP). For individual 3 strain - SRP = £5k, DSP = £19k so Cash payment = £19k - £5k = £14k. For individual 4 the strain – SRP = -£2k. DSP = £2k so cash payment = £2k – (-£2k) = £4k.

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Chart 3: Proposed reforms



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4 Member benefits on redundancy

This analysis assumed that the member elects for the following benefits on redundancy:

Immediate unreduced benefits, *plus*

If the member's statutory redundancy pay would have been more than the value of the strain cost, then the excess can be paid as a further cash benefit, up to the £95,000 exit payment cap, *plus*

If the member's discretionary severance payment would have been more than the value of the strain cost (net of statutory redundancy pay), then the excess can be paid as a further cash benefit up to the £95,000 exit payment cap.

All subject to the £95,000 cap.

Pension strain

An LGPS active member aged 55 or over who ceases employment on grounds of redundancy is entitled to immediate payment of pension without reduction¹.

Pension strain is calculated on a "past service reserve approach".

Pension strain is calculated as the difference between an immediate unreduced pension and a reduced pension, multiplied by the appropriate Pensioner Cash Equivalent Factor, plus the difference between an unreduced retirement grant and a reduced retirement grant.

Reduced benefits are calculated as follows:

- Pre 2014 benefits are reduced using strain calculation factors for enhanced early payment of post 2014 benefits.
- Post 2014 benefits are reduced using strain calculation factors for early payment of post 2014 benefits (which are reproduced from the standard early retirement factors).

Factors used are those currently in force.

Statutory redundancy pay

Statutory redundancy pay is a lump sum calculated in line with the 2019/20 statutory scheme², as follows:

- Half a week's pay for each full year aged under 22
- One week's pay for each full year aged 22 or older, but under 41
- One and half week's pay for each full year aged 41 or older
- Length of service is capped at 20 years
- Weekly pay is capped at £538

The maximum 2019/20 statutory redundancy pay is therefore £16,140 (= 1.5 x 20 x 538).

¹ <https://www.lgpsregs.org/schemeregs/lgpsregs2013/timeline.php#r30>

² <https://www.gov.uk/redundancy-your-rights/redundancy-pay>

Discretionary severance pay

Employers may offer discretionary severance pay in addition to statutory redundancy pay. The level of discretionary severance pay will vary by employer; in this paper we have followed the illustrative design used in the LGA consultation response³. Discretionary severance pay is such that the total of statutory redundancy pay and discretionary severance pay is a lump sum equal to:

$$\text{weekly pay} \times \text{statutory weeks} \times 1.5$$

where 'statutory weeks' is the number of week's pay included in the statutory redundancy payment, as above:

- Half a week's pay for each full year aged under 22
- One week's pay for each full year aged 22 or older, but under 41
- One and half week's pay for each full year aged 41 or older
- Length of service is capped at 20 years

³ http://lgpslibrary.org/assets/cons/nonscheme/20190410_95k_LR.pdf

Appendix A: Redundancy data

- A.1 The data used by GAD for this report consisted of data for 36,232 of the 37,296 redundancies documented to have taken place during the period 01/04/2013 to 31/03/2016 in the Local Government Finance Statistical Release (SF3) 08 December 2016. All results stated in this report have been rated up by 3% (37,296/36,232) to better reflect the overall aggregate costs to employers.
- A.2 The 3% difference between the SF3 figures and the data used in this report is a result of members being excluded from the data set as a result of having no salary figure listed.

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Appendix B: Compliance and limitations

- B.1 This work has been carried out in accordance with the applicable Technical Actuarial Standard: TAS 100 issued by the Financial Reporting Council (FRC). The FRC sets technical standards for actuarial work in the UK.
- B.2 The costs illustrated in this report are approximate and are intended to provide a high-level illustration of the impacts. The illustrations do not include the impact of taxation.
- B.3 This report is intended for the use of MHCLG for the purposes of developing policy on the proposed public sector exit payment cap. The information and advice in this report should not be relied upon, or assumed to be appropriate, for any other purpose or by any other person. GAD does not accept any liability to third parties, whether or not GAD has agreed to the disclosure of its advice to the third party.
- B.4 In preparing this report, GAD has relied on data and other information supplied on behalf of MHCLG as described in the report. Any checks that GAD has made on this information are limited to those described in the report, including any checks on the overall reasonableness and consistency of the data. These checks do not represent a full independent audit of the data supplied. In particular, GAD has relied on the general completeness and accuracy of the information supplied without independent verification.